**IN THE UNITED STATES BANKRUPTCY COURT**

**FOR THE DISTRICT OF IDAHO**

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| **IN RE** | ) | |
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| **FOR-ROSE PLUMBING, INC.,** | ) | **Case No. 98-02144** |
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| | ) | **MEMORANDUM OF DECISION** |
| | ) | **AND ORDER** |
| **Debtors.** | ) | |
| _____ | ) | |

HONORABLE TERRY L. MYERS, U.S. BANKRUPTCY JUDGE

Marc S. Tanner, Boise, Idaho, former counsel for the Debtor.

Martin J. Martelle, Boise, Idaho, counsel for the Debtor.

Jed W. Manwaring, EVANS KEANE, LLP, , Boise, Idaho for the Trustee.

Gary C. Thomas, Emmett, Idaho.

Bernie R. Rakozy, Boise, Idaho, chapter 7 Trustee.

Gary L. McClendon, Boise, Idaho, U.S. Trustee's Office.

The Court by prior Order initiated a review of the fees charged by and paid to Debtor's attorneys and other professionals in connection with this

chapter 7[1] case. Following hearing, the matter was taken under advisement. This memorandum constitutes the Court's findings and conclusions. Rule 7052.

**BACKGROUND**

The Debtor corporation filed a voluntary petition for relief under chapter 7 on June 26, 1998. No schedules or statements were filed with the petition.

Prior to filing the petition, Gary Thomas (as a "financial consultant") was hired by the Debtor to give advice regarding the business' cash flow and potential for reorganization. He was paid $300.00 by the Debtor.

Attorney Marc Tanner also provided services to the Debtor prior to filing the petition, and he signed the petition as attorney for the Debtor. Mr. Tanner continued to represent the Debtor until August 4, 1998, when Martin Martelle substituted as attorney of record for the Debtor. The last work that Mr. Tanner actually performed for the Debtor occurred on July 21, 1998.

Mr. Tanner's disclosure of compensation submitted to the Court on November 24, 1998, revealed that he received $5,000.00 from the Debtor on June 15, 1998. This payment was intended by the Debtor and Mr. Tanner to be a "flat fee" for all necessary work in the bankruptcy whether occurring before or after the petition. No written fee agreement existed. Of this $5,000.00, Mr. Tanner kept $2,500.00 and gave the other half to Mr. Martelle on July 31, 1998.

Mr. Martelle first worked for the Debtor on July 27, 1998. He has never withdrawn, or sought to withdraw, and continues to represent the Debtor in this case. Mr. Martelle's disclosure of compensation, received first as an exhibit to his affidavit filed December 1, 1998, then filed with the Court two months later on January 25, 1999, reveals that Mr. Martelle received the $2,500.00 from Mr. Tanner.

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[1] Unless otherwise indicated, all references to "code," "title," "chapter" and "section" are to the Bankruptcy Code, 11 U.S.C. §§ 101 - 1330, and all references to "rule" are to the Federal Rules of Bankruptcy Procedure ("Fed.R.Bankr.P.") 1001 - 9036.

On January 25, 1999, Mr. Martelle also disclosed that he had received $2,000.00 from principals of the Debtor, Greg and Ingrid Rose, for the purpose of representing them personally. An adversary proceeding had been initiated by the chapter 7 Trustee to recover estate assets allegedly in their possession. This suit commenced on July 23, 1998, a few days before Mr. Martelle came on board. Mr. Martelle advised the Roses in connection with the adversary, at the same time he was counsel for the Debtor corporation, until September 4, 1998.[2]

On November 19, 1998, in a hearing regarding the adversary proceeding, the Court discovered that the Debtor and/or the Roses had paid $7,000.00 in legal fees, but that the Roses were not represented in the adversary and could not afford counsel. The Court also determined that, though almost six months had elapsed since the petition, no fee disclosures had been filed at all in the chapter 7 case, that no schedules or statements had ever been filed,[3] and no first meeting of creditors had been held.

The Court, therefore, by *sua sponte* order, commenced a review of all attorneys' and professionals' fees in the chapter 7 case and the adversary proceeding, and required the submission of Rule 2016(b) disclosure statements by the attorneys, an accounting of all fees paid or promised to Messrs. Thomas, Tanner and Martelle, and an explanation for the state of the case.

Evidence was taken and argument heard at a hearing on December 7, 1998, after which the matter was taken under advisement. Briefs were later submitted by the U.S. Trustee, Mr. Tanner and Mr. Martelle.[4]

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[2] Because Mr. Martelle did not actually appear for the Roses in that case, he did not formally withdraw as counsel for them. He terminated his representation of the Roses by letter to them dated September 4, 1998.

[3] Mr. Martelle indicates he "assumed" the U.S. Trustee or chapter 7 Trustee would address the issue of the unfiled documents so he didn't, even though he still remained counsel of record and never sought to withdraw. This is an abdication of his responsibilities as counsel and an officer of the court.

[4] Mr. Martelle also filed a motion to allow him to file a reply brief to the U.S. Trustee's brief. This motion is granted. His reply brief has been reviewed by the Court.

## DISCUSSION

By any measure, the circumstances in this case necessitated judicial review. When the Court issued its November 1998 order, the case was almost six months old, but languishing. No first meeting had been held, and no schedules or statements had ever been filed, though two of this District's better-known debtors' counsel had appeared. Thousands of dollars had been paid to attorneys, something the Court only learned by happenstance during a related hearing; none of the required fee disclosures had ever been filed. Additionally, the Roses individually paid for representation in an adversary proceeding, but were now forced to represent themselves *pro se*. The Trustee was pursuing allegedly improper transfers, and bemoaning a lack of cooperation from the Debtor or counsel. There was ample justification for requiring the Debtor's attorneys to explain and defend their conduct.

This case raises several issues including the failure to file Rule 2016(b) compensation disclosures;[5] the conflict of interest in Mr. Martelle representing the corporation and the Roses simultaneously; the conduct of the case, including the failure to file required schedules and statements; the repeated failure to appear at first meeting; the allegations in the adversary proceeding concerning asset transfers; the propriety of the transfer of fees from Mr. Tanner to Mr. Martelle, especially in the absence of disclosure; and the reasonable value of the services performed by counsel under all the circumstances. This list is not exhaustive.

### Disclosure Issues

Section 329 requires debtor's attorneys to disclose any compensation paid or promised in such representation and authorizes the Court to determine whether those fees were reasonable. Specifically, § 329(a) provides:

> Any attorney representing a debtor in a case under this title, or in connection with such a case, whether or not such attorney applies for compensation under this title, shall file with the court a statement of the compensation paid or agreed to be paid, if such payment or agreement was made after one year before the date of

[5] The U.S. Trustee contends that even the belatedly made disclosures are materially inaccurate and incomplete.

> the filing of the petition, for services rendered or to be rendered in contemplation of or in connection with the case by such attorney, and the source of such compensation.

The method for disclosure of compensation is further addressed in Rule 2016(b), which states:

> **Disclosure of Compensation Paid or Promised to Attorney for Debtor.** Every attorney for a debtor, whether or not the attorney applies for compensation, shall file and transmit to the United States trustee within 15 days after the order for relief, or at another time as the court may direct, the statement required by § 329 of the Code including whether the attorney has shared or agreed to share the compensation with any other entity. The statement shall include the particulars of any such sharing or agreement to share by the attorney, but the details of any agreement for the sharing of the compensation with a member or regular associate of the attorney's law firm shall not be required. A supplemental statement shall be filed and transmitted to the United States trustee within 15 days after any payment or agreement not previously disclosed.

Failure to comply with these requirements warrants sanctions up to and including disallowance of all compensation and disgorgement of fees already received. *Law Offices of Nicholas A. Franke v. Tiffany (In re Lewis)*, 113 F.3d 1040, 1045 (9th Cir. 1997); *Neben & Starrett, Inc. v. Chartwell Financial Corp. (In re Park-Helena)*, 63 F.3d 877, 882 (9th Cir. 1995); *see also Hale v. United States Trustee (In re Basham)*, 208 B.R. 926, 931 (9th Cir. BAP 1997) (citing *Turner v. Davis, Gillenwater & Lynch (In re Investment Bankers, Inc.)*, 4 F.3d 1556, 1565 (10th Cir. 1993) *cert. denied* 510 U.S. 1114, 114 S.Ct. 1061, 127 L.Ed.2d 381 (1994)) ("[O]nce the bankruptcy court determines that an attorney has violated § 329 and 2016, the bankruptcy court has the authority to order the attorney to disgorge all of his fees.").

By their terms, the above disclosure requirements do not apply to Mr. Thomas as he did not provide legal advice to the Debtor.[6] He is not required

[6] However, the payment to Mr. Thomas, since it related to debt counseling and bankruptcy, must still be disclosed in response to Question 9

to submit a Rule 2016(b) disclosure, nor are his fees reviewable under § 329. Even if they were, Mr. Thomas has adequately justified the nature of his services and the reasonableness of compensation he received.

Additionally, to the extent Mr. Martelle provided services to entities other than the corporate Debtor, *i.e.*, to Greg and Ingrid Rose, he is not required to disclose his compensation, and his compensation for such services is not reviewable under § 329. [7]

Neither Mr. Tanner nor Mr. Martelle made timely disclosures of the compensation they received from the Debtor. Disclosures were made only after the Court ordered them to do so. To be timely, Mr. Tanner's disclosure should have been submitted by July 12, 1998; it was submitted November 24, 1998. Mr. Martelle's disclosure should have been submitted by August 15, 1998, but was not submitted until January 25, 1999. Since neither attorney complied with the statutory requirements, the Court could order disgorgement of all fees received in this case. *Lewis*, *supra; Basham*, *supra*.

Both attorneys claim that the failure to file was an oversight, and also justified by the burdens placed on them by the Roses, who are characterized as being "difficult" and "uncooperative." Counsel also claim that they didn't appreciate the fact that they could and should independently file the Rule 2016 disclosures, regardless of difficulties in getting the Debtor's schedules completed and filed.[8] Both Mr. Martelle and Mr. Tanner vow that their internal processes will change, and never again will Rule 2016(b) disclosures be untimely filed.

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on the Statement of Affairs.

[7] Should the Roses be dissatisfied with this representation of their personal interests, their rights and remedies regarding the attorney-client relationship under applicable non-bankruptcy law are not affected by or addressed in this decision.

[8] The information necessary to prepare a Rule 2016(b) disclosure is totally within the attorney's knowledge and control, and requires no input from, nor signature by, the debtor. There is no reason it can't be filed with the petition, or seasonably supplemented.

The Court finds it difficult to fully accept the various "justifications" which have been proffered for the failure to comply with Rule 2016(b). The requirement for this disclosure is (or certainly should be) well known, especially to experienced debtors' counsel. Here thousands of dollars were paid, and even transferred during the pendency of the case, yet neither attorney gave any apparent thought to their duties of disclosure. The Court would be justified in sanctioning for this neglect.

However, Mr. Martelle and Mr. Tanner promise that the problem will be remedied. Security for the performance of this obligation is found in the fact that the penalties of fee disallowance and disgorgement remain available -- and are likely -- should such a situation reoccur.

The Court chooses, under all the circumstances and in light of other decisions announced herein, not to impose sanctions for the late filing of the disclosures. This Court will, however, review the fees received by Mr. Tanner[9] for reasonableness under § 329(b).

**Reasonable Compensation to Mr. Tanner**

To the extent the compensation paid or agreed to be paid to a debtor's attorney for bankruptcy services exceeds the reasonable value of those services provided to the debtor, "the court may cancel any such agreement, or order the return of any such payment to the extent excessive, to -- (1) the estate, if the property transferred -- (A) would have been property of the estate; . . . or (2) the entity that made such payment." § 329(b).

Reasonableness under § 329(b) is determined by the same standards applied in § 330. *Basham*, 208 B.R. at 931. Section 330(a)(3)(A) provides:

> In determining the amount of reasonable compensation to be awarded, the court shall consider the nature, the extent, and the value of such services, taking into account all relevant factors, including --

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[9] A similar review which the Court has made of Mr. Martelle's fees raises several issues concerning the reasonableness of his charges. However, given other rulings explained later in this opinion, setting forth the details of that review is unnecessary.

> (A) the time spent on such services;
> (B) the rates charged for such services;
> (C) whether the services were necessary to the administration of, or beneficial at the time at which the service was rendered toward the completion of, a case under this title;
> (D) whether the services were performed within a reasonable amount of time commensurate with the complexity, importance, and nature of the problem, issue, or task addressed; and
> (E) whether the compensation is reasonable, based on the customary compensation charged by comparably skilled practitioners in cases other than cases under this title.

Bankruptcy services provided to the debtor include services leading to the filing of the petition for relief, and post-petition legal assistance with performing the debtor's duties under § 521. Those duties under § 521 include filing a list of creditors, schedules and statements, surrendering property of the estate and records to the trustee, cooperating with the trustee, and attending the § 341 meeting.

Calculation of a "lodestar" amount by multiplying the number of hours reasonably expended by an appropriate hourly rate, frames the analysis. *Pfeiffer v. Couch (In re Xebec)*, 147 B.R. 518, 524 (9th Cir. BAP 1992) (citing *In re Yermakov*, 718 F.2d 1465, 1471 (9th Cir. 1983) and *Blanchard v. Bergeron*, 489 U.S. 87, 94, 109 S.Ct. 939, 944-45, 103 L.Ed.2d 67 (1989)); *In re Western Quay Assoc. Ltd. Partnership*, 94 I.B.C.R. 193, 194 (Bankr.D. Idaho 1994).

Mr. Tanner asserts he should be compensated for 28.2 hours of his legal services at $85.00 per hour and for $175.00 in costs. He has provided an itemization of the time spent and services performed.

While there are clearly issues in this case with the performance of the Debtor's § 521 duties (filing schedules and statements, attending the first meeting, cooperating with the Trustee, etc.) not all of those arose during Mr. Tanner's watch. He transferred the case to Mr. Martelle with a set of draft schedules and statements (and with $2,500.00 as well, which will be addressed below). Mr. Tanner could arguably assume that the schedules would be finalized and filed, and the Debtor compelled to complete the performance of its duties, following the change in counsel. He admits that he did not properly

file his fee disclosure, but indicates that it was within the package of draft pleadings transferred to new counsel.

The Roses, as principals of the Debtor, clearly had some issues with Mr. Tanner's performance; they sought out new counsel to replace him. Yet little was provided the Court by the Roses in the way of specific objection to the services he performed or fees which were charged. Similar lack of specificity comes from the Trustee or U.S. Trustee.

On the record presented, the Court concludes that the fees charged by Mr. Tanner are generally reasonable, except in the following regards.

First, certain descriptions for the services rendered are illegible or not sufficiently detailed. Second, certain services appear to have been rendered to the principals of the Debtor, not the Debtor, and thus would not be properly compensable. These two categories, though, do not account for much of the total time charged.

Third, Mr. Tanner's approach to Rule 2016(b) was cavalier at best. He not only did not file any disclosure of the $5,000.00 received, he transferred half of this money post-petition without advising the Court, Trustee, or U.S. Trustee.

In general, the Court perceives that the Debtor may not have received full value for the $2,500.00 effectively paid Mr. Tanner. Many problems were left by him for the Debtor, new counsel, other litigants and the Court to address.

However, despite this perception, the Court has an insufficient record to quantify the diminution in value. Additionally, the rate charged of $85.00 per hour is less than the norm seen by the Court across the District. The Court concludes that using a rate of $85.00 per hour generates a lodestar amount commensurate with the level of skill and attention shown by Mr. Tanner in the performance of services in this case. Therefore no reduction will be ordered.

**Transfer of the Unearned Fee from Mr. Tanner to Mr. Martelle**

Numerous issues are raised by the Trustee and U.S. Trustee regarding Mr. Martelle's activities in the case. These include reduction of fees and disgorgement for failing to file timely or complete Rule 2016 disclosures,

similar sanctions for his tolerating a patent conflict of interest situation, and review and reduction of fees under § 329 based on an analysis of reasonable value. However, the Court concludes that the threshold issue is whether the payment Mr. Martelle received from Mr. Tanner may be properly retained at all.

The U.S. Trustee argues that when Mr. Tanner decided he hadn't earned the full $5,000.00 "flat fee" paid, the unearned portion was property of the estate, properly and necessarily deliverable to the chapter 7 trustee for administration. The Court agrees.

All legal or equitable interests of the debtor as of filing are property of the estate. § 541(a)(1). The scope of § 541 is intended to be broad. *United States v. Whiting Pools, Inc.*, 462 U.S. 198, 205 (1983); *In re Waters Asbestos Supply Co.*, 96.3 I.B.C.R. 103, 104 (Bankr.D. Idaho 1996). Whether a debtor's interest in property is property of the estate is a question of federal law. *First Federal Bank of California v. Cogar*, 210 B.R. 803, 808 (9th Cir. B.A.P. 1997). However the extent of the debtor's property interests is controlled by state law. *Id.; see also Butner v. United States*, 440 U.S. 48, 54 n.9 (1979); *In re McDonald Bros. Construction, Inc.*, 114 B.R. 989, 996 (Bankr.N.D.Ill. 1990).

In Idaho, retainers prepaying legal services to be rendered in the future belong to the attorney when transferred to the attorney. *State ex rel. Moore v. Scroggie*, 109 Idaho 32, 704 P.2d 364 (Ct.App. 1985). However, the attorney is obliged to earn the fees prepaid and make an accounting of such fees and costs to the client. *Moore*, 704 P.2d at 370. *See also* Idaho Rule of Professional Conduct 1.5(f). To the extent that the prepaid fees are unearned, the attorney must "reimburse" the client for the excess retainer paid. *Id.* To the extent the fees are unearned when representation of the client is completed (or ceases), they become property of the client. Stated another way, the client always retains the equitable rights to an accounting and to refund or reimbursement of any unearned portion of the prepaid fee.

When the $5,000.00 was paid to Mr. Tanner, it became his, but he was still obligated to account to the Debtor regarding his services and the value of those services. When Mr. Tanner's employment was terminated by the Debtor on or about July 29, 1998, he was obligated to return the unearned portion of the retainer to his client.

A chapter 7 trustee controls and administers all property of the estate. § 704. Property of the estate is comprised of, *inter alia*, all legal or equitable interests of the debtor in property as of the commencement of the case, and any interest in property that the estate acquires after commencement. § 541(a)(1), (7). All property of the estate must be turned over to the trustee. § 542.

The Court concludes that, under state law, the Debtor had an equitable interest in the prepaid fees as of the commencement of the case, and a prospective equitable entitlement to any unearned portion of this advance fee payment. When Mr. Tanner's representation was terminated, his client was entitled to the balance. At that time, his client, the corporation For-Rose Plumbing, Inc., was under the sole and exclusive control of the Trustee. The Trustee was entitled to receive the $2,500.00 as property of the estate.

Neither Greg Rose, who sought out Mr. Martelle to replace Mr. Tanner, nor the attorneys were free to decide that the unearned portion of the $5,000.00 should go to Mr. Martelle.[10] By then, the Trustee had succeeded to all interests of the Debtor. The attorneys were obligated to account to the Trustee, and turn over to the Trustee the unearned and properly reimbursable fees of $2,500.00.

The Court therefore finds and concludes that the $2,500.00 obtained by Mr.
Martelle shall be disgorged by him and turned over to the Trustee for administration in this case. By virtue of this ruling, several other issues have become moot.

For example, the U.S. Trustee sought full disgorgement of the same $2,500.00 because of Mr. Martelle's failure to comply with § 329 or Rule 2016 until ordered to do so by the Court, and due to his conflict of interest. The desired relief has already been granted, and the Court need not reach those questions.

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[10] Mr. Martelle's brief of January 5, at p.1, asserts that he and Mr. Tanner decided on the reasonable amount of compensation Mr. Tanner had earned, and determined that a transfer of half the retainer would be "appropriate."

Similarly, the parties have presented arguments as to whether or not Mr. Martelle's fees are reasonable under a § 329(b) analysis[11] and the Trustee and U.S. Trustee urge that any unreasonable and unearned portion should be returned. But the Court has found that all the funds received by Mr. Martelle are to be returned for other reasons, and it need not therefore enter findings or conclusions on the reasonableness of the fees he charged.[12]

**CONCLUSION AND ORDER**

The Court concludes services provided by Mr. Thomas, and services provided by Mr. Martelle to Greg and Ingrid Rose individually, are not reviewable under § 329.

The Court concludes that, under all the circumstances, the $2,500.00 retained by Mr. Tanner for his services is reasonable, and the § 329(b) request of the Trustee and U.S. Trustee to cancel the agreement and require disgorgement is denied. The Court further concludes that requiring Mr. Tanner to disgorge some or all of his fees as a sanction for the admitted failure to properly file his Rule 2016(b) disclosure is not warranted under all the circumstances.

The Court concludes that the $2,500.00 portion of the $5,000.00 not earned by Mr. Tanner prior to his termination is property of the estate. Such amount shall be turned over to the Trustee by Mr. Martelle. By virtue thereof, Mr. Martelle retains no funds in compensation of services rendered or to be rendered the Debtor, and § 329 review is moot. Also, by reason of this ruling, the question of disgorgement of fees paid Mr. Martelle by reason of his conflict of interest or failure to comply with Rule 2016(b) is rendered moot.

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[11] The parties have addressed several issues based on the record, including Mr. Martelle's conflict in representation, his overall conduct of the case (both what he did, and what he didn't do) since he replaced Mr. Tanner, and the appropriateness of his suggested rate of $150.00 per hour in light of this record.

[12] The issue of compensation to Mr. Martelle is not likely to arise later in this case. Section 330(a)(4)(B) does not provide for awards of fees to chapter 7 debtor's counsel from estate assets. *In re Kinnemore*, 181 B.R. 520, 95 I.B.C.R. 157 (Bankr.D.Id. 1995).

DATED this 30th day of April, 1999.